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Nigeria completes PC pre-payment

The Paris Club received an approval last Friday from the last creditor nation to agree to the final, US\$4.5bn repayment by Nigeria. As investors and bankers contemplate the prospect of fresh bonds from the country, the Paris Club is now looking at how to apply a similar repayment scheme to Angola. Richard Jory reports.

Nigeria has completed the pre-payment of the remaining US\$4.5bn owed to the Paris Club a month early, and is now contemplating total debt of just US\$5bn and reserves projected to reach US\$50bn by the end of the year. The only remaining confirmation, from a non-European Paris Club creditor country, was received in the late afternoon last Friday to complete the formalities.

The pre-payment concluded a process put in motion in March 2005, when Lazard was appointed to advise the Nigerian government on its Paris Club debt. An agreement with the Club was reached on October 20 last year on the basis of three payments: a US\$7.6bn repayment on October 31; another on December 12; with the final payment made on April 21 2006, after an approval from the IMF that followed its implementation of a Policy Support Instrument (PSI).

At the same time as reducing its outstanding debt by about US\$30bn in a year, Nigeria has also enacted a strong structural reform policy, which the Ministry of Finance kicked off in March 2004.

"The pre-payment a month early was a nice signal from the government," said Robert Kahn, head of the Public Sector Advisory Group at Citigroup. "This deal has resolved a huge debt overhang, but they wouldn't have done it if their macro policy had not been strong."

The IMF completed its first review under a two-year PSI for Nigeria on April 17, weeks after the country gained its first credit rating (see IFR 1619 p75).

"Monetary policy is anchoring macroeconomic stability," Anne Krueger, first managing director of the IMF, said in a statement. "Sales of foreign exchange through auctions and the issuance of CBN and Treasury bills play an important role in this regard, and the authorities are encouraged to increase the use of these indirect policy instruments and to allow greater exchange rate and interest-rate flexibility to dampen inflationary pressures effectively."

The country has clearly benefited from the strengthening of bank regulations introduced earlier this year, said Kahn. The rules raised the capital requirements for banks and in general strengthened the regulatory environment, which encouraged weaker banks to close.

Praise was also reserved for the Center for Global Development (CGD), a Washington-based think tank, which produced a paper in September 2004 that persuaded the World Bank to classify Nigeria as an IDA (International Development Agency) only country in July 2005. This opened the door for Naples Treatment by the Paris Club, said people close to the government. The CGD was also noted by the same source as the party that introduced the idea of debt buybacks at a discount.

When preliminary informal discussions on repayment started in September 2004 there was a strong resistance to debt relief for Nigeria, said the sources, which attributed the deal-making momentum to the UK, the largest creditor.

New funding calls

The completion of Paris Club negotiations has inspired talk of new issuance, although sources close to the Finance Ministry said that the government would resist a fresh debt deal as it was so happy to have got rid of its debt stack. Furthermore, it is questionable how appropriate it would be to issue new debt so soon after the Paris Club has given up on US\$18bn of the country's debt.

But a new issue would make sense, particularly if the proceeds were used to take out the par bonds that remain. This outstanding debt has a built-in call option, making for a distorted credit curve that does not serve as a benchmark.

"Retiring the par bonds is the next debate," said people close to the government. Meanwhile, investors continue to show interest in, and buy, naira-denominated local bonds.

The Paris Club is now looking at how it might apply the deal structured for Nigeria to negotiations recently revived with Angola, a country that shares almost the same economics. The trick appears to be to ensure the inclusion of a PSI, said those close to the Nigerian government, although it was clear that this (and the IMF rubber stamp that this entailed) was the only condition set by the Paris Club.

Resolving warrants

The final settlement with the Paris Club will leave only the outstanding issue of how to resolve the dispute over oil warrants that were issued (as separate securities) with bonds when Nigeria restructured its debt. Dealers and the trade association EMTA said in March they were looking to resolve discrepancies between the collateralised fixed bond

positions and the positions of the related payment-adjustment warrants. (See IFR 1624 p83.)

An industry-wide resolution based around a multilateral netting facility is expected by this autumn, following the completion of a similar transaction for Venezuela, according to Michael Chamberlain, executive director at EMTA. "We are proposing that this be settled on a cash basis, not as a physical exchange, because it is too hard to find the physical instruments," said Chamberlain.

The issue with Nigeria's warrants is less complicated than for Venezuela – which has warrants issued alongside different bonds in different currencies – as there was only one bond issued, but also because trading has been far less active.

"Though we foresee the Venezuela netting facility preceding the one for Nigeria, progress in the reconciliation is being made on both countries concurrently," said Chamberlain.

In theory, the warrants should have travelled with the bonds, he suggests but "in practice, most did not perfect the transfer of the warrants, in part due to transaction costs associated with processing the transfers . . . Buyers and sellers may have been at fault, but they didn't seem to mind as the securities [ie, the warrants] were valueless at the time."

The need to complete the necessary bilateral reconciliation as a necessary pre-condition is pressing. "There are many of pairs of counterparties and until a critical mass of these pairs have reconciled their claims, there is gridlock," said Chamberlain.